

# ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Oller, et al Analyst: Gloria McConnell Bill Number: SB 1439

Related Bills: See Prior Analysis Telephone: 845-4336 Amended Date: 05/24/02

Attorney: Patrick Kusiak Sponsor: \_\_\_\_\_

**SUBJECT:** FTB Tax Penalty Amnesty Program

DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended.

☒ AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

☒ AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERN stated in the previous analysis of bill as introduced February 14, 2002.

☒ FURTHER AMENDMENTS NECESSARY.

DEPARTMENT POSITION CHANGED TO \_\_\_\_\_.

☒ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED February 14, 2002, STILL APPLIES.

☒ OTHER - See comments below.

## SUMMARY

This bill would create a tax penalty amnesty program for certain taxpayers that have not reported or have underreported their income taxes.

## SUMMARY OF AMENDMENTS

The May 24, 2002, amendments change the amnesty window during which applications, returns, and payments would be filed. The window would be during FTB's peak filing season, January 1, 2003, to June 30, 2003, which was an implementation consideration identified in FTB's analysis of the bill as introduced.

With the change in the amnesty window, a portion of the net collections identified in the previous analysis would shift from the second fiscal year to the first fiscal year. The shift is reflected in the chart below.

The May 7, 2002, amendments resolved the implementation considerations identified in FTB's analysis of the bill as introduced. The amendments would:

- delay the window during which amnesty applications, returns, and payments could be filed. The window would begin during the latter half of FTB's peak filing season, March 1, 2003.
- clarify that FTB must receive the required tax returns and payments no later than two months after the last day of the amnesty application period.

Board Position:

<input type="checkbox"/> S	<input type="checkbox"/> NA	<input type="checkbox"/> NP
<input type="checkbox"/> SA	<input type="checkbox"/> O	<input type="checkbox"/> NAR
<input type="checkbox"/> N	<input type="checkbox"/> OUA	<input checked="" type="checkbox"/> PENDING

Department Director

Date

Brian Putler

6/10/02

- clarify that penalties attributable to final assessments could not be waived.
- clarify that amnesty is not applicable to taxpayers who met the specified criteria relating to criminal investigation as of the day before the amnesty window.
- clarify that an installment payment agreement would be acceptable in lieu of payment in full.
- clarify what actions FTB could take after the last day of the amnesty window.
- expressly authorize FTB to request information from taxpayers receiving amnesty to improve the administration of the tax law. Taxpayers receiving amnesty would be required to cooperate with FTB's request.

## **ANALYSIS**

### **THIS BILL**

Under this bill, taxpayers could apply for amnesty from January 1, 2003, to April 30, 2003 (amnesty window). No later than June 30, 2003, taxpayers that apply for the amnesty program must:

- file all delinquent income tax returns and necessary amended returns (amnesty returns), and
- pay the taxes and interest due in full (or as provided in the terms of an installment payment agreement).

New criminal actions could not be brought against the taxpayer for those taxable years for which amnesty is requested.

Tax penalties will not be waived for deficiency assessments that are final before January 1, 2003.

Amnesty would not be available for criminal violations for which as of January 1, 2003: (1) taxpayers are on notice by a complaint having been filed against the taxpayer; (2) the taxpayer is under criminal investigation, or (3) a court proceeding has already been initiated.

If, as a result of amnesty returns, FTB issues a notice of proposed assessment, FTB may impose penalties and bring criminal action only on the difference between the amount shown on the amnesty return and the correct amount.

FTB would be required to adequately publicize the amnesty program to maximize public awareness and participation.

### **IMPLEMENTATION CONSIDERATION**

The amnesty window under this bill would occur during the filing season for the 2002 tax year. Staff would be required to incorporate approximately 130,000 amnesty-related income tax returns and as many as three or four times that number of other types of amnesty-related communications (amnesty applications, payments, telephone calls, in-person contacts at district offices, and correspondence) into its usual ongoing filing services operation. This could create a substantial disruption of this normal operation.

Additionally, estimated revenues may be attainable but only if amnesty provides a sufficient incentive for taxpayers to come forward voluntarily and with extensive publicity efforts. Of further concern is the timing between the date this bill may be enacted and the amnesty window. Staff is concerned that this bill may not be enacted until fall 2002, which would allow only three months of publicity before the amnesty window opens. This may not be ample time to ensure its success.

Based on interviews with staff concerning the past amnesty program, staff has further refined its implementation plan for this bill and offers the following suggestions to enhance the success of the tax penalty amnesty program and the resulting revenue to the state. For convenience, the suggested amendments are attached. Attachment B reflects the fiscal and economic impact of the bill as amended May 24, 2002, and incorporates the impact from the suggested amendments.

- Intent language– the focus for the tax penalty amnesty program should be more prevalent in the bill. It is suggested that the bill provide that if taxpayers fail to come forward during amnesty that immediately following amnesty, FTB would step up its filing enforcement, criminal investigation, criminal prosecution activities, and activities to detect abusive tax shelters using federal and state information. (Amendment 1) The stepped up criminal investigation and prosecution activities would increase FTB's departmental costs for fiscal year 2003-04, and thereafter, but at the same time generate additional revenue.
- Regulations –while it is not anticipated that regulations would be needed for this bill, any regulations that may be needed should be exempt from the usual review required through the Administrative Procedure Act because of the need for urgency and expediency. (Amendment 4; SEC. 3)
- Appropriation – to ensure that the tax penalty amnesty program and the stepped up criminal investigation and prosecution activities will be funded, appropriations must be provided in the bill. (Amendment 4; SECS. 4 and 4.5)

#### TECHNICAL CONSIDERATION

The attached Amendment 2 makes a technical change to clarify that the final assessments for which penalties would be waived under amnesty would be other than final deficiency assessments.

The attached Amendment 3 makes a technical change to the date relative to criminal violations. The date should be that immediately preceding the amnesty window, December 31, 2002.

## FISCAL AND ECONOMIC IMPACT

The following chart reflects both the revenue and departmental cost estimate for this bill, as amended May 24, 2002. The change in the revenue estimate is primarily attributable to an:

- acceleration of revenue for fiscal year 2002-03 due to changing the amnesty window, and
- assumption that approximately 70% of the revenue will be accrued in fiscal year 2002-03.

Estimated Fiscal Impact of SB 1439, <u>As Amended 05-24-02</u> For Tax Liabilities Attributed to Tax Years Beginning Before 1/1/02 Fiscal Year (In Millions)				
	2002-03	2003-04	2004-05	Total for Program
Personal Income Tax Law (PIT)				
Total gross revenue	+\$81.5	+\$29.0	+\$ 6.0	+\$116.5
Collection absent amnesty <sup>1</sup>	-\$73.5	-\$26.5	-\$ 5.5	-\$105.5
Redirection of collection staff <sup>2</sup>	-\$ 3.0	-\$ 2.0		-\$ 5.0
<b>Net PIT revenue</b>	<b>+\$ 5.0</b>	<b>+\$ 0.5</b>	<b>+\$ 0.5</b>	<b>+\$ 6.0</b>
Corporation Tax Law (CTL)				
<b>Net CTL revenue</b>	<b>+\$ 4.0</b>	<b>+\$ 1.5</b>	<b>+\$ 0.5</b>	<b>+\$ 6.0</b>
<b>Total Net Revenue</b>	<b>+ \$ 9.0</b>	<b>+\$ 2.0</b>	<b>+\$ 1.0</b>	<b>+\$ 12.0</b>
<b>Departmental costs:</b>				
Programming, testing	\$ .4			
Taxpayer communication, receiving and processing applications/returns	\$ 1.9	\$ 1.2		
Publicity <sup>3</sup>	\$ 2.0			
<b>Less Total Departmental Costs</b>	<b>- \$ 4.3</b>	<b>- \$ 1.2</b>	<b>minor</b>	<b>- \$ 5.5</b>
<b>Net Collections to the State</b>	<b>+ \$ 4.7</b>	<b>+ \$ 0.8</b>	<b>+ \$1.0</b>	<b>+ \$ 6.5</b>

(This revenue estimate reflects a revenue shift from that previously provided during the Senate Appropriation Committee hearing as follows: an increase of \$8.5 million for 2002-03, a decrease of \$7 million for 2003-04, and a decrease of \$1.5 million for 2004-05.)

<sup>1</sup> Reflects the revenue that would be generated from FTB's existing audit and filing enforcement programs even without this amnesty bill.

<sup>2</sup> Anticipates redirecting six collectors to the amnesty program the first year (2002-03) and reducing the redirection to only four collectors for the second year (2003-04).

<sup>3</sup> Standard publicity costs. To maximize publicity, however, it may cost an additional \$1 million, which is reflected in Attachment B.

## ARGUMENTS/POLICY CONCERNS

The applicable arguments/policy issues raised in FTB's previous analysis are restated below:

- The 1984-85 amnesty program was viewed in part as a long-term strategy to improve taxpayer compliance. However, even with that amnesty program and the many enhancements to the enforcement laws, FTB's practices, and FTB's information sources, potentially tens of thousands of taxpayers who either have not reported or have underreported their income still remain undetected. Providing a second amnesty, under this bill, might encourage at least some of these otherwise undetected taxpayers to come into the tax system.
- This bill could benefit tax law-abiding businesses. Under this bill, tax law-abiding businesses and those businesses that will become tax law-abiding under amnesty would both be paying their fair share of taxes. By both paying their fair share, their cost of doing business would be relatively more comparable, and, hence, their bids on jobs more fairly competitive.
- The cost to benefit ratio (CBR) for this amnesty program would be approximately 1:2, which is less than the CBR of FTB's audit and other enforcement activities that are funded through the usual budget process.
- Programming, managerial, and other key staff may need to be redirected from other projects or core functions. Many of these experienced or key people would undoubtedly be redirected from revenue-producing activities, as reflected in the above revenue estimate. Such redirection may also result in backlogs in other operations within the FTB, negatively affecting the quality of service that otherwise would be given by FTB staff. The current hiring freeze could make the redirection of staff to an amnesty program an even more critical issue for FTB.
- Experience with the 1984-85 amnesty program indicates that the estimated workload and time necessary to resolve the amnesty accounts could be understated. To the extent that this is the case, a General Fund deficiency for fiscal year 2002-03 would be needed in addition to the appropriation suggested in this analysis. Under the present budgetary process, the likelihood of readily receiving such a deficiency to complete the unforeseen amnesty workload would be remote.
- Having another amnesty program after expressly providing that the Legislature intended for the 1984-85 amnesty program to be a one-time occurrence may undermine similar statutory recitals of the Legislature. It may also create cynicism among law-abiding taxpayers who will see tax debtors again benefiting from reoccurring noncompliance.
- On occasion prosecuting attorneys (Attorney General, district attorneys, and city attorneys) may seek FTB's assistance in their criminal cases where a person has received income as a result of criminal activities. FTB assists in these cases when the person has criminally violated the income tax law by not reporting that income to FTB. If FTB were contacted by a prosecuting attorney during the amnesty window, FTB staff would most likely have to delay working with that prosecuting attorney until the window for applying for amnesty is closed. The delay would be needed to ascertain whether the offender files or has time to file the returns under amnesty.

Also, if amnesty were granted, unless there is a clear exception in the amnesty provisions to allow FTB to assist in these criminal prosecutions, FTB may be unable to do so within the spirit of amnesty. For this reason, prosecuting attorneys may have concerns with amnesty. From a criminal justice perspective, giving amnesty to income tax law criminal offenders is akin to not taking criminal action against bank robbers just because they surrender and return the money from a bank robbery.

## **LEGISLATIVE STAFF CONTACT**

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FRANCHISE TAX BOARD'S  
Implementation Consideration Suggested Amendments to SB 1439  
As Amended May 7, 2002

AMENDMENT 1

On page 2, line 1, after SECTION 1., insert:

It is the intent of the Legislature, in enacting tax penalty amnesty, as provided by this act, to further improve voluntary compliance with state income tax laws and to accelerate the collection of currently owed state income taxes. The Legislature finds and declares that a public purpose is served by the waiver of tax penalties and criminal prosecutions in return for the immediate reporting and payment of previously underreported and unreported tax liabilities. The benefits gained by this program include, among other things, accelerating receipt of taxes currently owed, permanently bringing into the tax system taxpayers that have been evading taxes, and providing an opportunity for taxpayers to clear their records and satisfy tax obligations before:

(1) the federal government further acts to curb the promotion and use of abusive tax shelters using information it received from its recent tax shelter disclosure program and it enacts proposed federal tax shelter law changes, and  
(2) FTB uses federal tax shelter audit information for state tax purposes, conforms to any federal tax shelter law changes, and steps-up its filing enforcement activities, criminal investigations, criminal prosecutions, and its own tax shelter audits.

SEC. 2

AMENDMENT 2

On page 2, line 27, strike out "an assessment" and insert:

deficiency assessments

AMENDMENT 3

On page 2, line 30, strike out "January 1, 2003" and insert:

December 31, 2002

#### AMENDMENT 4

On page 4, after line 12, insert:

##### SEC. 3.

The legislature finds that it is essential for fiscal purposes that the tax penalty amnesty program authorized by this act be expeditiously implemented. Accordingly, Chapter 3.5 (commencing with Section 11340) of Part 1 of Division 3 of Title 2 of the Government Code shall not apply to any determination, rule, notice, or guideline established or issued in implementing and administering the program authorized by this act.

SEC. 4 There is hereby appropriated from the General Fund for the 2002-03 fiscal year the sum of five million three hundred thousand dollars (\$5,300,000) to the Franchise Tax Board, in augmentation of Item 1730-001-0001 of the Budget Act of 2002.

SEC. 4.5 There is hereby appropriated from the General Fund for the 2003-04 fiscal year the sum of one million six hundred thousand dollars (\$1,600,000), to the Franchise Tax Board, in augmentation of Item 1730-001-0001 of the Budget Act of 2003.

## Attachment B

SB 1439; Implementation Considerations, <u>As Proposed to be Amended</u> For Tax Liabilities Attributed to Tax years Beginning Before 1/1/02 Fiscal Year (In Millions)				
	2002-03	2003-04	2004-05	Total for Program
Personal Income Tax Law (PIT)				
Total gross revenue	+\$81.5	+\$29.4	+\$ 6.9	+\$117.8
Collection absent amnesty <sup>1</sup>	-\$73.5	-\$26.5	-\$ 5.5	-\$105.5
Redirection of collection staff <sup>2</sup>	-\$ 3.0	-\$ 2.0		-\$ 5.0
<b>Net PIT revenue</b>	<b>+\$ 5.0</b>	<b>+\$ 0.9</b>	<b>+ \$ 1.4</b>	<b>+\$ 7.3</b>
Corporation Tax Law (CTL)				
<b>Net CTL revenue</b>	<b>+\$ 4.0</b>	<b>+\$ 1.5</b>	<b>+\$ 0.5</b>	<b>+\$ 6.0</b>
<b>Total Net Revenue</b>	<b>+\$ 9.0</b>	<b>+\$ 2.4</b>	<b>+\$ 1.9</b>	<b>+\$ 13.3</b>

<b>Departmental costs:</b>				
Programming, testing	\$ .4			
Taxpayer communication, receiving and processing applications/returns	\$ 1.9	\$ 1.2		
Publicity <sup>3</sup>	\$ 3.0			
Investigation staff <sup>4</sup>		.4	\$ .3	
<b>Less Total Departmental Costs</b>	<b>- \$ 5.3</b>	<b>- \$ 1.6</b>	<b>- \$ .3</b>	<b>- \$ 7.2</b>

<b>Net Collections to the State</b>	<b>+ \$ 3.7</b>	<b>+ \$ 0.8</b>	<b>+ \$ 1.6</b>	<b>+ \$ 6.1</b>
<b>Cost to Benefit ratio</b>				<b>1:1.9</b>

<sup>1</sup> Reflects the revenue that would be generated from FTB's existing audit and filing enforcement programs even without this amnesty bill.

<sup>2</sup> Anticipate redirecting six collectors to the amnesty program the first year (2002-03) and reducing the redirection to four collectors for the second year (2003-04).

<sup>3</sup> Publicity costs sufficient to ensure successful campaign. For standard publicity costs, costs would be reduced by \$1 million.

<sup>4</sup> Seven investigative staff to pursue additional information sources relative to potential criminal activities.